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United States
Department *of* Defense



Army Vessels Maintenance Contracts
in Southwest Asia

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Acronyms and Abbreviations

COR	Contracting Officer's Representative
DFARS	Defense Federal Acquisition Regulation Supplement
FAR	Federal Acquisition Regulation
HEISCO	Heavy Engineering Industries & Shipbuilding Company
IGE	Independent Government Estimate
J&A	Justification and Approval
LSV	Logistics Support Vessel-4
MARAV	Master Agreement for Repair and Alteration of Vessels
MICC-EU	Mission and Installation Contracting Command-Fort Eustis
NRCC	Naval Regional Contracting Command Naples, Detachment Bahrain
U.S.C.	United States Code



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
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ARLINGTON, VIRGINIA 22202-4704

May 21, 2010

MEMORANDUM FOR ASSISTANT SECRETARY OF THE ARMY (FINANCIAL
MANAGEMENT AND COMPTROLLER)
AUDITOR GENERAL, DEPARTMENT OF THE ARMY
INSPECTOR GENERAL, DEPARTMENT OF THE NAVY

SUBJECT: Army Vessels Maintenance Contracts in Southwest Asia (Report
No. D-2010-064)

We are providing this report for review and comment. This is the second report in a series of audits of the Army and Navy ship maintenance contracts. We considered management comments on a draft of this report when preparing the final report.

The Assistant Secretary of the Army (Financial Management and Comptroller), and Legal Counsel, Fleet and Industrial Supply Center, Sigonella, Detachment Bahrain, comments were responsive. However, the Director, Mission and Installation Contracting Command-Fort Eustis, provided generally favorable comments, but they were received too late to include in the report. DOD Directive 7650.3 requires that all issues be resolved promptly. Therefore, if the Director, Mission and Installation Contracting Command-Fort Eustis, does not submit additional comments by June 21, 2010, we will consider the comments received as the response to the final report. Due to management actions, we added Recommendation B.3 to the final report. Therefore, we request that the Director, Mission and Installation Contracting Command-Fort Eustis, comment on Recommendation B.3 by June 21, 2010.

If possible, send a .pdf file containing your comments to audacm@dodig.mil. Copies of your comments must have the actual signature of the authorizing official for your organization. We are unable to accept the / Signed / symbol in place of the actual signature. If you arrange to send classified comments electronically, you must send them over the SECRET Internet Protocol Router Network (SIPRNET).

We appreciate the courtesies extended to the staff. Please direct questions to me at (703) 604-9071 (DSN 664-9071).

A handwritten signature in black ink, appearing to read "Bruce A. Burton", is positioned above the printed name.

Bruce A. Burton
Deputy Assistant Inspector General
Acquisition and Contract Management



Results in Brief: Army Vessels Maintenance Contracts in Southwest Asia

What We Did

The overall objective was to determine whether contracts providing ship repairs and maintenance to the Army operations in Kuwait and Navy operations in Bahrain and United Arab Emirates were properly managed and administered. For this report, we reviewed competition, price reasonableness determinations, and quality assurance controls in 15 contracts valued at \$51.8 million for Army vessels maintenance in Kuwait. The findings on the two Navy locations will be included in follow-on reports.

What We Found

The Mission and Installation Contracting Command-Fort Eustis (MICC-EU) adhered to the surveillance and acceptance requirements for contracts reviewed. However, MICC-EU contracts did not have adequate contract competition, price reasonableness determinations, and funding. Specifically, MICC-EU contracting officers:

- did not adhere to competition requirements for all 15 contracts because they relied on an incorrect legal opinion from Naval Regional Contracting Command Naples, Detachment Bahrain (NRCC); as a result, they may not have obtained the best price for approximately \$51.8 million in contracting actions;
- did not ensure price reasonableness determinations were performed because they did not follow the Federal Acquisition Regulation; as a result, they may not have obtained the lowest price for more than \$29.9 million in sole-source contracting actions; and
- incorrectly funded one contract because the contracting officer used \$2.9 million in FY 2006 funds instead of FY 2007 funds; as a result, they violated the bona fide needs rule and may have violated the Antideficiency Act.

What We Recommend

The Assistant Secretary of the Army (Financial Management and Comptroller) initiate a preliminary review of the potential Antideficiency Act violation to determine whether a violation occurred, and provide the results to the Office of Inspector General.

The Director, MICC-EU:

- require contracting officers to provide full and open competition, justify and document all contract awards without adequate competition;
- require contracting officers to stop using the June 8, 2004, NRCC Legal Counsel memorandum;
- require the contracting officers to request other than cost and pricing data, document fair and reasonable price determinations, and establish employee performance standards for contracting officers; and
- correct funding for contract W912SU-06-G-0003-0008 with the appropriate fiscal year funds (if available) to address the bona fide needs rule violation.

The Legal Counsel, Fleet and Industrial Supply Center, Sigonella, Detachment Bahrain, withdraw the NRCC memorandum, dated June 8, 2004.

Management Comments and Our Response

The Assistant Secretary of the Army (Financial Management and Comptroller) and the Legal Counsel, Fleet and Industrial Supply Center, Sigonella, Detachment Bahrain, were responsive to Recommendations C.2 and A.2 respectively. Because management developed new policies during the audit that were not formalized, we added Recommendation B.3 to the final report. The Director, MICC-EU, provided generally favorable comments, but they were received too late to include in the report. We request the Director, MICC-EU, comment on Recommendation B.3 by June 21, 2010. Please see recommendations table on page ii.

Recommendations Table

Management	Recommendations Requiring Comment	No Additional Comments Required
Assistant Secretary of the Army (Financial Management and Comptroller)		C.2
Director, Mission and Installation Contracting Command-Fort Eustis	B.3	A.1, B.1, B.2, and C.1
Legal Counsel, Fleet and Industrial Supply Center, Sigonella, Detachment Bahrain		A.2

Please provide comments by June 21, 2010.

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Introduction

Objectives

This is the second in a series of reports on the Army and Navy ship maintenance contracts for Southwest Asia. The overall objective was to determine whether contracts providing ship repairs and maintenance to Army operations in Kuwait and Navy operations in Bahrain and United Arab Emirates were properly managed and administered. The audit series will include reports on the contracts we reviewed in the U.S. Army, Mission and Installation Contracting Command-Fort Eustis (MICC-EU); U.S. Naval Sea Systems Command; and the Fleet and Industrial Supply Center. For this report, we reviewed competition, price reasonableness determinations, and quality assurance controls in 15 contracts valued at \$51.8 million for Army vessels maintenance in Kuwait. The findings on the two Navy locations will be included in follow-on reports. See Appendix A for a discussion of our scope and methodology.

We performed this audit pursuant to Public Law 110-417, “The National Defense Authorization Act for Fiscal Year 2009,” section 852, “Comprehensive Audit of Spare Parts Purchases and Depot Overhaul and Maintenance of Equipment for Operations in Iraq and Afghanistan.” Section 852 requires “thorough audits to identify potential waste, fraud, and abuse in the performance of Department of Defense contracts, subcontracts, and task and delivery orders for (A) depot overhaul and maintenance of equipment for the military in Iraq and Afghanistan; and (B) spare parts for military equipment used in Iraq and Afghanistan.”

Background

U.S. Army Materiel Command

The U.S. Army Materiel Command provides materiel readiness—technology, acquisition support, materiel development, logistics power projection, and sustainment—to the Army, including the joint military operations. The Army Materiel Command is the overarching organization for the Army Contracting Command, Army Sustainment Command, and TACOM Life Cycle Management Command.

Army Logistics Support Vessel



Source: <http://www.naval-technology.com/projects/lsv/lsv1.html>

Army Contracting Command

The Army Contracting Command is the managing organization for the Mission and Installation Contracting Command. The mission of the Army Contracting Command is to provide worldwide support to the warfighter's mission requirements through contracting support for the acquisition of goods and services. The Army Contracting Command performs the majority of the Army's contracting work and consists of two subordinate commands, the Mission and Installation Contracting Command and the U.S. Army Expeditionary Contracting Command.

Mission and Installation Contracting Command

The Mission and Installation Contracting Command has seven contracting centers including MICC-EU. MICC-EU is the contracting office in charge of the Army contracts in our sample and is responsible for base operations contracts in support of Fort Monroe, Fort Story, Fort Eustis, Fort Lee, Fort Leavenworth, and Carlisle Barracks. In addition, MICC-EU provides contracting support to the TACOM Life Cycle Management Command depot-level maintenance for all Army watercraft in Kuwait. Through an agreement between TACOM Life Cycle Management Command and the Army Sustainment Command, MICC-EU provides contracting support for the Care of Stocks in Storage requirements.

Army Sustainment Command

The Army Sustainment Command is responsible for a wide range of logistics missions in support of current and future combat operations. The Army Sustainment Command is responsible for field-level maintenance (below depot-level) for the Army prepositioned stock watercraft. The Army Sustainment Command established the requirements for 3 of the 15 contracts in our sample.

TACOM Life Cycle Management Command

The TACOM Life Cycle Management Command is responsible for life cycle management of the Army's ground and soldier systems and for systems and equipment supporting other services. The TACOM Life Cycle Management Command is responsible for sustainment-level (depot-level) shipyard maintenance for Army watercraft in Kuwait and established the requirements for 12 of the 15 Army contracts in our sample.

Watercraft Inspection Branch

Watercraft Inspection Branch personnel, under TACOM Life Cycle Management Command, are the technical and subject matter experts for the maintenance of Army watercraft. The Watercraft Inspection Branch ensures the watercraft fleet is operational, safe, and seaworthy. The Watercraft Inspection Branch conducts technical inspections, develops maintenance specifications, and provides the contracting officer's representatives (CORs) to oversee the work of the contractors on-site in Kuwait.

Basic Ordering Agreements

For this audit, we judgmentally selected 15 firm-fixed-price contracts based on geographical location and high dollar value amounting to approximately \$51.8 million

issued under basic ordering agreements. The Federal Acquisition Regulation (FAR) states that basic ordering agreements are not contracts and defines them as written negotiated agreements between the contracting office and the contractor that contain the terms and clauses applying to future contracts. The work being performed on the ships includes programmed dry-docking, cleaning, painting, and repair of the vessels.

Master Agreement for Repair and Alteration of Vessels

The 15 contracts reviewed were ordered under a Master Agreement for Repair and Alteration of Vessels (MARAV). Defense Federal Acquisition Regulations Supplement (DFARS) Subpart 217.71, “Master Agreement for Repair and Alteration of Vessels,” is a written instrument of understanding, negotiated between a contracting activity and a contractor that contains elements of a contract, but is not a contract. DFARS states that when soliciting for contracts issued under a MARAV, the contracting officer must solicit offers from both contractors with MARAVs and contractors without MARAVs who possess the necessary qualifications to perform the work and agree to execute a MARAV before award of the contract.

Review of Internal Controls

DOD Instruction 5010.40, “Managers’ Internal Control (MIC) Program Procedures,” January 4, 2006, requires DOD organizations to implement a comprehensive system of internal controls that provides reasonable assurance that programs are operating as intended and to evaluate the effectiveness of the controls. We determined that MICC-EU adhered to the surveillance and acceptance requirements by appropriately designating a COR on site for all contracts reviewed. Specifically, the contracting officers included quality assurance measures built into the contracts identifying testing points that required COR surveillance. To show their surveillance, the CORs created daily logs and weekly progress reports documenting their consistent oversight of the contractor’s performance. In addition, the CORs approved the invoices to show the Government received the correct quantity and quality of work required before accepting the services. However, we determined that MICC-EU did not have adequate internal controls for contract competition, price reasonableness determination, and funding. See the audit findings for detailed information. Implementing the recommendations in Findings A, B, and C will improve MICC-EU’s internal controls. We will provide a copy of the report to the senior official responsible for internal controls at the Army Contracting Command and MICC-EU.

Finding A. Competition

The MICC-EU contracting officers did not allow for full and open competition as required by the FAR when awarding 15 contracts worth approximately \$51.8 million. This occurred because MICC-EU contracting officers did not review the international agreement with Kuwait that they relied on when they awarded all 15 contracts to one contractor. This also occurred because MICC-EU Legal Counsel instructed the contracting officer to rely on an incorrect Naval Regional Contracting Center Naples, Detachment Bahrain (NRCC) Legal Counsel opinion concerning MARAV holders to justify sole-sourcing the contracts. As a result, the Army lost the benefits of competing bids and obtaining the best price for the 15 contracts.

Criteria

The United States Code and the FAR provide guidance on contract competition requirements to ensure contracting officers appropriately perform contract administration and make informed decisions. According to section 2304, title 10, United States Code, (10 U.S.C. 2304), “Contracts: Competition Requirements,” and FAR Subpart 6.1, “Full and Open Competition,” contracting officers must provide for full and open competition through the use of competitive procedure(s) for all acquisitions. When used with respect to a contract action, the FAR defines full and open competition as permitting all responsible sources to compete for the contract. However, FAR Subpart 6.3, “Other Than Full and Open Competition,” allows contracting officers to award sole-source contracts without providing for full and open competition if one of the following exceptions found in FAR Subpart 6.302, “Circumstances Permitting Other Than Full and Open Competition,” and 10 U.S.C. 2304 applies:

- only one responsible source;
- unusual and compelling urgency;
- industrial mobilization, engineering, developmental, research capability, or expert services;
- international agreement;
- authorized or required by statute;
- national security; or
- public interest.

In addition, the FAR states that “each contract awarded without providing for full and open competition shall contain a reference to the specific authority under which it was awarded.”

FAR Subpart 6.302-4, “International agreement”

FAR Subpart 6.302-4, “International agreement,” states that full and open competition need not be provided for when precluded by the terms of an international agreement or a treaty between the United States and a foreign government or international organization. Contracting officers using this authority to award contracts are not required to provide written justification and approval (J&A) for DOD. Therefore, the contracting officers should provide for full and open competition or create a J&A for a sole-source contract

meeting one of the exceptions listed above, unless a valid international agreement was created.

DFARS 217.7103, “Master Agreements and Job Orders”

DFARS 217.7103, “Master Agreements and Job Orders,” states that when soliciting for contracts issued under a MARAV, the contracting officer must solicit offers from both contractors with MARAVs and contractors without MARAVs who possess the necessary qualifications to perform the work and agree to execute a MARAV before award of the contract. The contracting officer still must provide for full and open competition as required by FAR Subparts 6.1 and 6.3. DFARS states that for emergency work, the contracting officer may issue a contract to a MARAV holder without soliciting offers when a delay in the performance of necessary repair work would endanger the vessel or if the military requires immediate work to be performed on the vessel. When issuing a contract due to emergency work, DFARS states that the “contracting officer shall obtain approval from the head of the contracting activity” before awarding the contract.

Reliance on Others

The MICC-EU contracting officers awarded 15 sole-source contracts solely on the verbal advice of NRCC officials or a written opinion from the NRCC Legal Counsel.¹ Specifically, MICC-EU contracting officers stated that the NRCC officials told them that an international agreement existed that required all ship maintenance repair contracts to be awarded only to Heavy Engineering Industries & Shipbuilding Company (HEISCO). The MICC-EU contracting officers told us that they had never seen the international agreement and in fact sometimes doubted that it existed. We eventually obtained a copy of the classified international agreement from TACOM Life Cycle Management Command. The international agreement was signed in 1991 by then-Secretary of Defense Richard Cheney and a Kuwaiti government official. MICC-EU contracting officers could not provide a copy of the agreement or explain why they relied on a document that they had never read. We reviewed the international agreement and could not find any direction, statement, or requirement in the agreement that directed U.S. Government contracting officers to award contracts only to HEISCO or any other Kuwaiti contractor.

MICC-EU contracting officers stated that they also used a NRCC Legal Counsel memorandum as a basis for awarding the contracts for ship maintenance in Kuwait. Specifically, they stated that in the event that the international agreement did not meet the FAR requirements for limiting competition, the contracting office would rely on the NRCC Legal Counsel memorandum. The memorandum is a legal opinion, dated June 8, 2004, by the NRCC Legal Counsel.² The MICC-EU legal counsel reviewed and agreed with the NRCC Legal Counsel memorandum.

¹ The Fleet and Industrial Supply Center Sigonella Detachment Bahrain, formerly NRCC, administered the Army vessels contracts in Kuwait prior to MICC-EU. Therefore, MICC-EU adapted NRCC procedures in its contract administration.

² Due to attorney-client privilege, the NRCC Legal Counsel memorandum could not be quoted or included in this report.

The basis of the NRCC Legal Counsel memorandum is that a justification and approval document is not required if the contractor is a MARAV holder. The memorandum based its statements on 10 U.S.C. 2304, “Contracts: competition requirements”; FAR Subpart 6.2, “Full and Open Competition After Exclusion of Sources”; FAR Subpart 6.3, “Other Than Full and Open Competition”; and 10 U.S.C 2319, “Encouragement of New Competitors.” The rationale used in the NRCC Legal Counsel memorandum is that MARAV holders are part of a prequalified list known in the FAR as the qualified products list. The memorandum concludes that solicitations involving only MARAV holders do not require preparation of a J&A under FAR Subpart 6.3, because the qualified products list process is an exception to the requirement for full and open competition.

However, the following case law and regulation cited in the NRCC Legal Counsel memorandum contradict the NRCC Legal Counsel’s conclusion.

- Government Accountability Office, case law B-261267, September 28, 1995, “Matter of: Supreme Edgelight Devices, Inc.,” states that the use of the qualified products list restricts competition and potential offerors must have the opportunity to demonstrate their ability to provide an acceptable product.
- FAR Subpart 9.2, “Qualifications Requirements,” and 10 U.S.C. 2319 state that “if a potential offeror can demonstrate, to the satisfaction of the contracting officers, that the potential offeror meets the standards established for qualification or can meet them before the date specified for award of the contract, the potential offeror may not be denied the opportunity to submit or be considered for a contract solely because the potential offeror—(1) Is not on a qualified products list, qualified manufacturers list, or qualified bidders list maintained by the DOD.”

The criteria and case law cited in the NRCC Legal Counsel memorandum state that being on a qualified products list does **not** exclude MICC-EU from the competition requirements in the FAR and DFARS. [emphasis added]

The NRCC Legal Counsel’s opinion contained in the memorandum was inconsistent and unclear. Specifically, when providing for other than full and open competition, FAR Subparts 6.2 and 6.3 require the contracting officer to create either a determination and finding or a J&A for the contract, **unless** an international agreement has been established. [emphasis added] The NRCC Legal Counsel memorandum did not provide a valid basis for its conclusion that a J&A was not required. MICC contracting officers relied on the legal opinion, however, and did not create J&As for contracts issued to the Heavy Engineering Industries & Shipbuilding Company, a MARAV holder.

Recommendations, Management Comments, and Our Response

A.1. We recommend that the Director, Mission and Installation Contracting Command-Fort Eustis:

- a. Require contracting officers to provide for full and open competition as required by the Federal Acquisition Regulation Subpart 6.1, "Full and Open Competition"; Subpart 6.302, "Circumstances for Permitting Other Than Full and Open Competition"; Subpart 6.303-1, "Justifications"; section 2304, title 10, United States Code, "Contracts: Competition Requirements"; and Defense Federal Acquisition Regulation Supplement 217.7103, "Master Agreements and Job Orders," to all ship maintenance contracts.
- b. Require contracting officers to document and justify all contract awards using any criteria other than full and open competition as required by the Federal Acquisition Regulation Subpart 6.1, "Full and Open Competition."
- c. Require contracting officers to discontinue their use of the June 8, 2004, Naval Regional Contracting Center Naples, Detachment Bahrain, Legal Counsel memorandum as an exception for circumventing full and open competition requirements.

Director, Mission and Installation Contracting Command-Fort Eustis, Comments Received Late

The Director, Mission and Installation Contracting Command-Fort Eustis, provided generally favorable comments on the draft report; however, they were received too late to be included in the final report. Therefore, if the Director, Mission and Installation Contracting Command-Fort Eustis, does not submit additional comments, we will consider those comments as the management response to the final report.

A.2. We recommend that the Legal Counsel, Fleet and Industrial Supply Center, Sigonella, Detachment Bahrain, withdraw the Naval Regional Contracting Center Naples, Detachment Bahrain, memorandum dated June 8, 2004.

Legal Counsel, Fleet and Industrial Supply Center, Sigonella, Detachment Bahrain, Comments

The Legal Counsel, Fleet and Industrial Supply Center, Sigonella, Detachment Bahrain, agreed with Recommendation A.2. The Legal Counsel, Fleet and Industrial Supply Center, Sigonella, Detachment Bahrain, stated that the Naval Regional Contracting Center Naples, Detachment Bahrain, memorandum dated June 8, 2004, was withdrawn.

Our Response

The Legal Counsel, Fleet and Industrial Supply Center, Sigonella, Detachment Bahrain, comments were responsive, and the actions meet the intent of this recommendation.

Finding B. Price Reasonableness

The contracting officers at MICC-EU did not ensure that price reasonableness determinations were performed for more than \$29.9 million awarded in sole-source contracts. Specifically, the contracting officers did not ensure price reasonableness was determined for 4 of the 15 contracts when initially awarded for \$18.2 million, and for all 15 contracts when over and above work was added amounting to an additional \$11.8 million. This occurred because the contracting officers did not review or document the price reasonableness determinations conducted by the COR to verify that these determinations were complete or met FAR Part 15, “Contracting by Negotiation,” requirements. As a result, MICC-EU contracting officers may not have received the lowest price for more than \$29.9³ million in contracting actions.

Federal Acquisition Regulation

FAR Part 15 states that contracting officers must purchase supplies and services at fair and reasonable prices. FAR Subpart 15.403-3, “Requiring information other than cost or pricing data,” states that the contracting officer is responsible for obtaining information that is adequate for evaluating the reasonableness of the price. The contracting officer must require the offeror to submit information that, at a minimum, includes appropriate information on the prices at which the same or similar item has previously been sold. In addition, the FAR states that the Government may use various price analysis techniques and procedures to ensure it gets a fair and reasonable price. Some of the techniques include: a comparison of previously proposed prices, a comparison of proposed prices with independent Government estimates (IGEs), a comparison of proposed prices with those obtained through market research for the same or similar items, and analysis of pricing information provided by the offeror. FAR Subpart 15.406-3, “Documenting the Negotiation,” states that “the contracting officer shall document in the contract file the principal elements of the negotiated agreement,” including the fair and reasonable pricing determination. The documentation shall include an explanation of any significant differences between the two positions.

Original Contract

We reviewed 15 contracts valued at approximately \$51.8 million that were issued by the MICC-EU contracting officer using a basic ordering agreement. We found that four contracts, awarded for \$18.2 million, did not comply with requirements for evaluating price reasonableness. FAR 15.3, “Source Selection,” states that, normally, competition establishes price reasonableness. However, these contracts were awarded to one contractor without soliciting other bids. Therefore, the lack of competition requires the contracting officer to perform additional actions to ensure fair and reasonable prices were received. The MICC-EU contracting officers awarded the four contracts for amounts that exceeded the IGEs by \$5.5 million. However, the contracting files did not contain price reasonableness determinations or documentation justifying the decision to award the contracts for the proposed amounts. Table 1 illustrates the amount awarded over the IGE for the four contracts.

³ The total does not equal the sum of \$18.2 million and \$11.8 million due to rounding.

Table 1: Contracts Exceeding the IGE

Contract	Awarded Value	IGE Amount	Value of Awarded Amount Exceeding the IGE	Percent Awarded Over IGE
W912SU-06-G-0003-0009	\$6,748,220	\$4,078,000	\$2,670,220	65.48
W912SU-06-G-0003-0012	1,794,670	1,376,200	418,470	30.41
W912SU-06-G-0003-0013	2,205,020	1,841,050	363,970	19.77
W912SU-06-G-0003-0019	7,404,069	5,396,550	2,007,519	37.20
Total	\$18,151,979	\$12,691,800	\$5,460,179	

The CORs stated that they created the IGEs based on historical data and experience. Then the contracting officers stated that as part of their price analysis review, they compare the contractors' proposals against the IGEs. According to the chief contracting officer, during the comparison of the two documents, if the contractor's price was too high or too low, the contracting officer would ask the COR to review the bid and verify that the prices were appropriate. The COR stated that they would then verbally explain to the contracting officer why the contractor's price was reasonable or not, but neither the contracting officer nor the COR documented this rationale in the contracting file. As a result, the contracting files did not contain any documentation or cost or pricing data to support that the awarded prices were fair and reasonable or to explain why the four contracts were awarded for amounts significantly more than the IGEs. The contracting officers' employee performance standards did not include a rating element to measure the contracting officer's performance for determining and documenting that the prices are fair and reasonableness as required by FAR Subpart 15.406-3.

Management Actions

During the audit, the MICC-EU contracting personnel initiated action to document appropriate price reasonableness determinations. Since June 2009, the contracting officers prepared negotiation documents for each contract to summarize the negotiation process and document the price reasonableness determination. We reviewed an example of a negotiation document and determined that the example met FAR requirements for documenting significant differences between a contractor's proposal and an IGE. When we asked if standard operating procedures existed for questioning contract line item numbers that had significant variances from the IGE, the contracting officers stated that there were no standard operating procedures currently in place. In September 2009, the chief contracting officer decided on a standard variance amount and sent an e-mail to all contracting officers requiring them to question contract line item numbers with a 15 percent differential between the contractor's proposal and the IGE.

Over and Above Work

The DFARS Clause 252.217-7028, "Over and Above Work," defines over and above work as additional work discovered during the performance of a contract that is not covered by the line item(s) for the basic contracted work, but is needed to complete the

task. DFARS also states that once the proposal is received for the over and above work, the Government and the contractor will negotiate a price.

We found that over and above work totaling \$11.8 million was added to the 15 contracts reviewed. However, the contracting officers did not use any cost comparison procedures to determine whether the additional costs added to the contracts were fair and reasonable. Instead, the contracting officer relied on the COR to determine whether price reasonableness was met, but did not review or document the price reasonableness determined by the COR to verify it was complete or that it met FAR Part 15 requirements. Table 2 lists the original contract value and the value of the over and above work for of the contracts reviewed.

Table 2: Over and Above Work

Contract	Original Contract Value	Value of Over and Above Work With No Price Reasonableness Justification
W912SU-06-G-0003-0006	\$1,500,500.00	\$268,290.33
W912SU-06-G-0003-0007	1,504,200.00	276,761.89
W912SU-06-G-0003-0008	2,737,250.00	1,730,162.97
W912SU-06-G-0003-0009	6,748,220.00	2,591,369.77
W912SU-06-G-0003-0012	1,794,670.00	55,488.37
W912SU-06-G-0003-0013	2,205,020.00	346,993.02
W912SU-06-G-0003-0017	3,260,380.00	868,578.89
W912SU-06-G-0003-0018	4,049,862.00	1,267,181.49
W912SU-06-G-0003-0019	7,404,069.79	1,712,683.07
W912SU-06-G-0003-0021	2,928,889.00	406,594.47
W912SU-06-G-0003-0024	1,936,640.00	258,128.82
W912SU-06-G-0003-0025	2,161,708.00	356,445.64
W912SU-06-G-0003-0026	7,799,661.00	682,091.71
W912SU-06-G-0003-0027	3,265,882.00	597,674.86
W912SU-06-G-0003-0029	2,487,676.00	334,990.26
Total	\$51,784,627.79	\$11,753,435.56

The CORs stated that they performed price reasonableness determinations for the over and above work based on previous contracts and Internet researches. However, the CORs did not provide this information to the contracting officers. The chief contracting officer stated that the only price reasonableness documentation created for the over and above work added was the specifications worksheets signed by both the COR and the contract-ing officer. These documents were created by the COR to initiate the contract modifica-tions when over and above work was added. However, the contracts' specification worksheets signed by the CORs only verified that the work identified was technically acceptable. According to the specification worksheet, the contracting officers were responsible for verifying that the final negotiated price was fair and reasonable. The contracting officers stated that they relied on the CORs, as the technical experts, to ensure fair and reasonable prices were obtained for the over and above work added to the

contracts. The CORs did not sign contracts and were not held personally liable. The contracting officers did not review or document the CORs' price reasonableness determinations to verify that they were complete or that they met FAR 15 requirements.

Conclusion

The contracting officers did not adequately comply with price reasonableness requirements during the award of 4 of the 15 contracts valued at \$18.2 million, but they have begun creating negotiation documents for all contracts and instructed all contracting officers to question contract line item numbers with a 15 percent differential from the related IGE. All 15 contracts lacked price reasonableness documentation and support for the over and above work added, and no policy has been established to correct this deficiency. The employee performance standards for contracting officers do not include rating elements for holding the contracting officers accountable for completing and documenting price reasonableness determinations.

Recommendations, Management Comments, and Our Response

Added Recommendation

Because management developed new policies that were not formalized, we added Recommendation B.3 to the final report.

B. We recommend that the Director, Mission and Installation Contracting Command-Fort Eustis:

1. Require the contracting officers to request other than cost and pricing data from Heavy Engineering Industries & Shipbuilding Company for the ship maintenance work performed, as required by Federal Acquisition Regulation Subpart 15.403-3, "Requiring information other than cost and pricing data," and document the fair and reasonable price decision, including actions for additional work, as required by Federal Acquisition Regulation Subpart 15.406-3, "Documenting the negotiation." The determination should include detailed evaluation of the prices and not merely arbitrary comparisons between a proposal and the independent Government estimate.

2. Establish employee performance standards for contracting officers to hold them accountable for completing and documenting price reasonableness determinations to include all additional work put on contract.

3. Develop and implement formal policies for questioning contract line item variances and officially establish the percent differential between the contractor's proposal and the independent Government estimate and disapprove or recompetete any differences identified.

Director, Mission and Installation Contracting Command-Fort Eustis, Comments Received Late

The Director, Mission and Installation Contracting Command-Fort Eustis, provided generally favorable comments on the draft report; however, they were received too late to be included in the final report. Therefore, if the Director, Mission and Installation Contracting Command-Fort Eustis, does not submit additional comments, we will consider those comments as the management response to the final report.

Due to management actions, we added Recommendation B.3 to the final report. Therefore, we request the Director, Mission and Installation Contracting Command-Fort Eustis, comment on Recommendation B.3 by June 21, 2010.

Finding C. Financial Accountability Improvements Needed

The MICC-EU contracting officer incorrectly funded the W912SU-06-G-0003-0008 contract. This occurred because the contracting officer used \$2.9 million in FY 2006 funds instead of FY 2007 funds. As a result, the MICC-EU contracting officer violated the bona fide needs rule and may have violated the Antideficiency Act.

Bona Fide Needs

Section 1502, title 31, United States Code, “Balances available,” states that “the balance of an appropriation or fund limited for obligation to a definite period is available only for payment of expenses properly incurred during the period of availability or to complete contracts properly made within that period of availability.” Financial Management Regulation 7000.14-R, volume 3, chapter 8, “Standards for Recording and Reviewing Commitments and Obligations,” states that “current fiscal year appropriations may be obligated for those maintenance and repair contracts awarded near the end of the fiscal year, even though contractor performance may not begin until the following fiscal year.” The Financial Management Regulation states that “the contract shall satisfy a bona fide need that arose in or before the fiscal year of the appropriation charged. In addition, contracts awarded near the end of the fiscal year shall contain a specific requirement that the work begin before January 1 of the following calendar year.” However, an Antideficiency Act violation occurred if obligations and expenditures of funds do not provide for a bona fide need of the fund or account and corrective funds are not continuously available.

The *Principles of Federal Appropriations Law*, chapter 5, “Availability of Appropriations: Time,” published by the Comptroller General, quotes the Comptroller of the Treasury, stating that a violation of the bona fide needs rule occurs when year-end spending is used to purchase an article not necessary for use in the fiscal year in which it was ordered but purchased merely to use up year-end appropriations. It states that when an obligation is made toward the end of a fiscal year for which it is clear that the need relates to the following fiscal year, the bona fide needs rule has been violated. When this happens, the obligation is not properly charged against the earlier appropriation, but must be charged against the following year’s funds. In addition, the *Principles of Federal Appropriations Law* states that appropriations made for a definite period of time may be used only for expenses properly incurred during that period of time and references the bona fide needs statute (31 U.S.C. 1502[a]).

Contract W912SU-06-G-0003-0008

The scope of work for contract W912SU-06-G-0003-0008 was to provide programmed dry-docking, cleaning, painting, and repairs to the U.S. Army Logistics Support Vessel-4 (LSV), stationed at Muhammad al-Ahmad Naval Base, Kuwait. The original contract for W912SU-06-G-0003-0008 was awarded by MICC-EU on September 27, 2006, and funded with \$2,933,463.92 in FY 2006 money.

The contracting file contained e-mail communications between the customer and the command, discussing when the LSV could have its maintenance performed. The customer stated that the LSV was being funded with Global War on Terrorism⁴ money and needed to be put on contract by the end of 2006. He stated that it was not just about spending the money, but also about getting the time slot for the ship. The command personnel stated that placing the LSV into the shipyard in January 2007 would not suit the command. The command stated that they understood that using FY 2006 end of year funds for this action was a use-or-lose situation, but they needed the actual work to be delayed until March 2007. The customer stated that he would look for a legal avenue in which they could defer the ship maintenance work until March 2007, but still use end of year 2006 money to fund the effort.

The chief contracting officer requested an opinion from her legal counsel on the matter; the chief contracting officer stated her concerns with a bona fide needs rule violation using FY 2006 funds for the vessel when it would not go into the shipyard until at least halfway through FY 2007. The contracting office's legal counsel agreed and stated that the only possible way they could use FY 2006 funds for LSV was if they ordered long-lead items prior to December 31, 2006. The documentation the contracting officer provided to show that a long-lead item was ordered was not adequately supported. The item ordered could not be tracked back to contract W912SU-06-G-0003-0008 because it contained no contract number, no billing information, and was not located in the contracting file. Instead, the contracting office had to obtain the documentation from the contractor when the auditors requested support for the long-lead items. After reviewing the contracting file, we concluded that a bona fide need did not exist for the ship in FY 2006. From available e-mail documents, it is apparent that the contracting officer was aware that the work on the ship would not commence until March 2007. In addition, the contract did not contain the specific requirement that work begin before January 1 of the following calendar year and the contracting officer did not document in the contracting file that she verified that work began on the ship prior to the end of the year.

Conclusion

The contracting officer violated the bona fide needs rule for contract W912SU-06-G-0003-0008 and potentially violated the Antideficiency Act. The contracting officer should have funded the contract with FY 2007 funds instead of FY 2006 funds. By using the wrong year funds, the contracting officer may have circumvented Congress' constitutional powers of controlling the budgetary expenditures made by the Federal Government.

⁴ Global War on Terror was the term used to refer to military operations in Iraq and Afghanistan. These operations are now known as Operations in Southwest Asia.

Recommendations, Management Comments, and Our Response

C.1. We recommend that the Director, Mission and Installation Contracting Command-Fort Eustis:

- a. Correct prior incorrect funding for contract W912SU-06-G-0003-0008 with the correct appropriate and fiscal year funds, if available. If those funds are not available, then an Antideficiency Act violation has occurred.
- b. Review all maintenance repair contracts awarded near the end of a fiscal year to ensure that the contract requires work to begin before January 1 of the following calendar year and that appropriate contract documentation is included in the contracting file.
- c. Develop internal controls to ensure that all maintenance repair contracts awarded near the end of a fiscal year require work to begin before January 1 of the following calendar year and appropriate contract documentation is obtained for the contracting file.

Director, Mission and Installation Contracting Command-Fort Eustis, Comments Received Late

The Director, Mission and Installation Contracting Command-Fort Eustis, provided generally favorable comments on the draft report; however, they were received too late to be included in the final report. Therefore, if the Director, Mission and Installation Contracting Command-Fort Eustis, does not submit additional comments, we will consider those comments as the management response to the final report.

C.2. We recommend that the Assistant Secretary of the Army (Financial Management and Comptroller):

- a. **Initiate a preliminary review of the potential Antideficiency Act violation within 10 days of the final report to determine whether a violation occurred.**
- b. **Complete a preliminary review within 90 days as required by DOD Regulation 7000.14-R, “DOD Financial Management Regulation,” volume 14, chapter 3, “Preliminary Reviews of Potential Violations,” and provide the results of the preliminary investigation to the Office of Inspector General.**

Assistant Secretary of the Army (Financial Management and Comptroller) Comments

The Assistant Secretary of the Army (Financial Management and Comptroller) agreed with Recommendation C.2. The Assistant Secretary of the Army (Financial Management and Comptroller) stated that pursuant to volume 14, chapter 3 of the Department of

Defense Financial Management Regulation, a directive was sent to the U.S. Army Materiel Command on March 30, 2010, requiring them to initiate a preliminary review.

Our Response

The Assistant Secretary of the Army (Financial Management and Comptroller) comments were responsive, and the actions meet the intent of this recommendation.

Appendix. Scope and Methodology

We conducted this performance audit from March 2009 through March 2010 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

This is the second in a series of reports on the Army and Navy ship maintenance contracts. We announced this audit in March 2009 and judgmentally selected 17 Navy Fleet and Industrial Supply Center Sigonella Detachment Bahrain contracts, 15 Army MICC-EU contracts, and 7 Naval Sea Systems Command technical instructions, valued at \$96,839,887, based on geographical location and high dollar value. We selected this sample from a universe of 2,934 contracts valued at \$171,901,765. However, during the fieldwork stage of the audit, the team identified that the potential issues pertaining to the Fleet and Industrial Supply Center Sigonella, Army, and Naval Sea Systems Command contracts were notably different. This report addresses the 15 Army contracts, valued at approximately \$51.8 million. We met with officials from the Army Materiel Command, Army Sustainment Command, TACOM Life Cycle Management Command, and the Surface Deployment and Distribution Command at Fort Belvoir, Virginia. We visited MICC-EU Vessels Branch in Norfolk, Virginia, from April 27, 2009, through May 1, 2009. We also met with officials from the U.S. Army Central Command and visited the CORs stationed in Kuwait from June 5, 2009, to June 8, 2009. The scope of this project is limited to the specific Army contracts observed during our site visit to the MICC-EU contracting office in Virginia and to the HEISCO shipyard and Kuwait Naval Base in Kuwait. The contracts we reviewed were awarded between September 26, 2006, and March 10, 2009. The results of the review of the 15 Army contracts are included in this report, but follow-on reports will address the issues regarding the other contracts.

We reviewed Federal and DOD criteria regarding quality assurance and surveillance to evaluate whether the MICC-EU vessels maintenance contracts in Southwest Asia complied with the criteria. We conducted extensive research of Federal and DOD criteria relating to contract quality assurance and surveillance requirements, competition, and price reasonableness requirements. The specific criteria reviewed included the FAR, the DFARS, Government Auditing Standards, and the United States Code.

Use of Computer-Processed Data

We used computer-processed data from the Federal Procurement Data System-Next Generation to help choose our judgmental sample of contracts for the audit. We queried all contract actions related to ship maintenance performed in the U.S. Central Command countries since FY 2004. However, we did not rely on this data to support our findings. Therefore, we did not perform a reliability assessment of the computer-processed data.

Prior Coverage

No prior coverage has been conducted on ship maintenance contracts in Southwest Asia for MICC-EU during the last 5 years.

Assistant Secretary of the Army (Financial Management and Comptroller) Comments



REPLY TO
ATTENTION OF

DEPARTMENT OF THE ARMY
OFFICE OF THE ASSISTANT SECRETARY OF THE ARMY
FINANCIAL MANAGEMENT AND COMPTROLLER
109 ARMY PENTAGON
WASHINGTON DC 20310-0109

APR 2 2010

MEMORANDUM THRU Auditor General, Department of the Army, 3101 Park Center Drive, Alexandria, Virginia 22302-1596


FOR Inspector General, Department of Defense, Defense Business Operations, 400 Army Navy Drive, Arlington, Virginia 22202-4704

SUBJECT: Draft report, Army Vessels Maintenance Contracts in Southwest Asia (project number: D2009-D000AS-0163.001)

1. We appreciate the opportunity to comment on subject report and are providing our reply to Recommendation C2.

2. Pursuant to Volume 14, Chapter 3 of the Department of Defense Financial Management Regulation (February 2008), the Army is required to initiate a preliminary review within 30 days of the receipt of draft audit findings alleging that a potential ADA may have occurred. A directive was sent to the U.S. Army Materiel Command on March 30, 2010 requiring them to initiate a preliminary review.

3. My point of contact for this report is [REDACTED] who can be reached at [REDACTED]


John J. Argodale
Deputy Assistant Secretary of the Army
(Financial Operations)

Fleet and Industrial Supply Center, Sigonella, Detachment Bahrain Comments

Office of General Counsel
Fleet and Industrial Supply Center Sigonella
Detachment Bahrain
PSC 451 BOX 430
FPO AE 09834-2800

16 March 2010

From: Counsel, FISCSI Detachment Bahrain
To: Department of Defense Inspector General

Subj: Draft Report Army Vessels Maintenance Contracts in Southwest Asia
(Project No. D2009-D000AS-0163.001)

1. In response to Recommendation A.2 of the subject draft report, the Naval Regional Contracting Center Naples, Detachment Bahrain (NRCC) legal counsel letter dated 8 June 2004 is withdrawn.

2. Additional questions or concerns may be directed to me at the above address or the following e-mail account: [REDACTED]


Robert L. Kois, Jr.
Counsel



Inspector General Department of Defense